



A REPORT
TO THE
MONTANA
LEGISLATURE

FINANCIAL-COMPLIANCE AUDIT

Department of Environmental Quality

*For the Two Fiscal Years Ended
June 30, 2020*

SEPTEMBER 2021

LEGISLATIVE AUDIT
DIVISION

20-16

LEGISLATIVE AUDIT COMMITTEE

REPRESENTATIVES

KIM ABBOTT

Kim.Abbott@mtleg.gov

DENISE HAYMAN, CHAIR

Denise.Hayman@mtleg.gov

EMMA KERR-CARPENTER

Emma.KC@mtleg.gov

TERRY MOORE

terry.moore@mtleg.gov

MATT REGIER

Matt.Regier@mtleg.gov

JERRY SCHILLINGER

jerry.schillinger@mtleg.gov

SENATORS

JASON ELLSWORTH, VICE CHAIR

Jason.Ellsworth@mtleg.gov

JOHN ESP

Johnesp2001@yahoo.com

PAT FLOWERS

Pat.Flowers@mtleg.gov

TOM JACOBSON

Tom.Jacobson@mtleg.gov

TOM MCGILLVRAY

Tom.McGillvray@mtleg.gov

MARY McNALLY

McNally4MTLeg@gmail.com

MEMBERS SERVE UNTIL A
MEMBER'S LEGISLATIVE TERM
OF OFFICE ENDS OR UNTIL A
SUCCESSOR IS APPOINTED,
WHICHEVER OCCURS FIRST.

§5-13-202(2), MCA

FRAUD HOTLINE
(STATEWIDE)
1-800-222-4446
(IN HELENA)
444-4446
LADHotline@mt.gov
www.montanafraud.gov

FINANCIAL-COMPLIANCE AUDITS

Financial-compliance audits are conducted by the Legislative Audit Division to determine if an agency's financial operations are properly conducted, the financial reports are presented fairly, and the agency has complied with applicable laws and regulations. In performing the audit work, the audit staff uses standards set forth by the American Institute of Certified Public Accountants and the United States Government Accountability Office. Financial-compliance audit staff members hold degrees with an emphasis in accounting and many staff members hold Certified Public Accountant (CPA) certificates.

The Single Audit Act Amendments of 1996 and the Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards require the auditor to issue certain financial, internal control, and compliance reports in addition to those reports required by *Government Auditing Standards*. This individual agency audit report is not intended to comply with these reporting requirements and is therefore not intended for distribution to federal grantor agencies. The Legislative Audit Division issues a statewide biennial Single Audit Report which complies with the above reporting requirements. The Single Audit Report for the two fiscal years ended June 30, 2019, was issued March 30, 2020. The Single Audit Report for the two fiscal years ended June 30, 2021, will be issued by March 31, 2022.

AUDIT STAFF

STEVEN ALTHOFF

JENNIFER ERDAHL

LESLIE LAHTI

DELSI OSMANSON

MARY V. YUREWITCH

JESSICA CURTIS

DON ERDMANN

ALEXA O'DELL

SHENAE STENSAAS

KELLY ZWANG

Reports can be found in electronic format at:

<https://leg.mt.gov/lad/audit-reports>

LEGISLATIVE AUDIT DIVISION

Angus Maciver, Legislative Auditor
Deborah F. Butler, Legal Counsel



Deputy Legislative Auditors:
Cindy Jorgenson
William Soller

September 2021

The Legislative Audit Committee
of the Montana State Legislature:

This report documents the results of our financial-compliance audit of the Department of Environmental Quality (department) for the two fiscal years ended June 30, 2020. We completed work over licenses and permits revenues, federal revenues, and expenditures related to personal services, contracted services, and transfers-out activity. We also completed work over cash balances, investments, and reviewed compliance with federal regulations governing the state revolving fund loan programs.

Four recommendations related to internal control deficiencies over financial activity resulted from our audit effort. The deficiencies affected the department's indirect cost rate calculations and indirect cost recoveries, IT capital assets, pollution remediation liabilities, and transfers activity.

The department's written response to the audit recommendations is included in the audit report on page C-1. We thank the director and his staff for their cooperation and assistance throughout the audit.

Respectfully submitted,

/s/ Angus Maciver

Angus Maciver
Legislative Auditor

TABLE OF CONTENTS

Figures and Tables.....	ii
Appointed and Administrative Officials	iii
Report Summary	S-1
CHAPTER I – INTRODUCTION AND BACKGROUND	1
Introduction.....	1
Background.....	1
Prior Audit Recommendations.....	2
CHAPTER II – FINDINGS AND RECOMMENDATIONS.....	5
Indirect Costs.....	5
Indirect Cost Rate Calculation Errors.....	5
Indirect Cost Recoveries Accounting Errors	6
Information Technology System Accounting Errors	7
Pollution Remediation	8
Prior Year Accounting Errors	9
Summary	10
INDEPENDENT AUDITOR’S REPORT AND DEPARTMENT FINANCIAL SCHEDULES	
Independent Auditor’s Report	A-1
Schedule of Changes in Fund Equity for the Fiscal Year Ended June 30, 2020	A-3
Schedule of Changes in Fund Equity for the Fiscal Year Ended June 30, 2019.....	A-4
Schedule of Total Revenues & Transfers-In for the Fiscal Year Ended June 30, 2020	A-5
Schedule of Total Revenues & Transfers-In for the Fiscal Year Ended June 30, 2019.....	A-6
Schedule of Total Expenditures & Transfers-Out for the Fiscal Year Ended June 30, 2020	A-7
Schedule of Total Expenditures & Transfers-Out for the Fiscal Year Ended June 30, 2019.....	A-8
Notes to the Financial Schedules	A-9
REPORT ON INTERNAL CONTROL AND COMPLIANCE	
Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Schedules Performed in Accordance With <i>Government</i> <i>Auditing Standards</i>	B-1
DEPARTMENT RESPONSE	
Department of Environmental Quality	C-1

FIGURES AND TABLES

Tables

Table 1	Internal Service Fund Indirect Cost Recovery Misstatements.....	6
Table 2	IT Asset Understatements	7
Table 3	Prior Year Line Item Overstatements	9

APPOINTED AND ADMINISTRATIVE OFFICIALS

Department of Environmental Quality

Christopher Dorrington, Director (effective January 2021)

Shaun McGrath, Director (through December 2020)

George Mathieus, Deputy Director

Sonja Nowakowski, Air, Energy & Mining Division Administrator

Jenny Chambers, Waste Management & Remediation Division
Administrator

Amy Steinmetz, Water Quality Division Administrator

			<u>Term Expires</u>
Board of Environmental Review	Steven Ruffato, Chair	Columbus	January 1, 2025
	Julia Altemus	Missoula	January 1, 2023
	Hillary Hanson	Kalispell	January 1, 2023
	David Lehnherr	Red Lodge	January 1, 2023
	Jon Reiten	Billings	January 1, 2025
	David Simpson	Billings	January 1, 2025
	Joseph Smith	Florence	January 1, 2025
Petroleum Tank Release Compensation Board	Keith Schnider, Presiding Officer	Great Falls	July 1, 2022
	Grant Jackson	Helena	July 1, 2024
	Mark Johnson	Bozeman	July 1, 2022
	Kristi Kline	Kremlin	July 1, 2023
	John Monahan	Missoula	July 1, 2024
	Heather Smith	Bozeman	July 1, 2023
	Calvin Wilson	Bozeman	July 1, 2022

For additional information concerning the Department of Environmental Quality, contact:

Cassy Anderson
Chief Financial Officer
Department of Environmental Quality
P.O. Box 200901
Helena, MT 59620-0901
406-444-2855

e-mail: Cassandra.Anderson@mt.gov



MONTANA LEGISLATIVE AUDIT DIVISION

Department of Environmental Quality FOR THE TWO FISCAL YEARS ENDED JUNE 30, 2020

BACKGROUND

The Department of Environmental Quality (department) is charged with helping protect the environment as guaranteed to the citizens of Montana by the state's constitution.

The department promotes clean air and minimizing pollution; implements measures to protect water quality; permits and regulates hard rock, coal and opencut mining; and helps reduce risk of public exposure to contaminants from unpermitted and historical releases of waste to the environment.

To fulfill its obligations, the department is organized into six programs: Central Management; Air, Energy, and Mining; Water Quality; Waste Management and Remediation; Libby Asbestos Superfund Oversight Committee; and Petroleum Tank Release Compensation Board.

Director:

Christopher Dorrington

As a result of the department not implementing recommendations from the prior audit, several multimillion-dollar errors were recorded in fiscal years 2019 and 2020. While these errors did not affect the overall quality of the department's financial reports, some affected the preparation of the state's basic financial statements. The department has an opportunity to enhance controls to avoid similar errors in future reporting periods.

AUDITOR'S OPINION (page A-1): UNMODIFIED

We determined the department's financial schedules and note disclosures presented fairly, in all material respects, the activity of the department and issued unmodified opinions on each of the fiscal year 2020 and 2019 financial schedules. This means the reader can rely on the presented information as well as the underlying accounting records.

For the full context of the department's financial activity, see the financial schedules and notes beginning on page A-4.

RECOMMENDATIONS:

In this report, we issued the following recommendations:

To the department: 4

To the legislature: 0

In this report, we determined the implementation status of recommendations in the prior audit:

Fully Implemented: 0

Partially Implemented: 1

Not Implemented: 2

RECOMMENDATION #1 (page 5):

Internal control deficiency

We recommend the Department of Environmental Quality enhance internal controls over the department's indirect cost rate calculation and to ensure the subsequent indirect cost recoveries are recorded in the correct accounts on the state's accounting records per state accounting policy.

Department response: **Concur**

(continued on back)

For the full report or more information, contact the Legislative Audit Division.

leg.mt.gov/lad

Room 160, State Capitol
PO Box 201705
Helena, MT 59620-1705
(406) 444-3122

The mission of the Legislative Audit Division is to increase public trust in state government by reporting timely and accurate information about agency operations, technology, and finances to the Legislature and the citizens of Montana.

To report fraud, waste, or abuse:

Online
www.Montanafraud.gov

Email
LADHotline@mt.gov

Call
(Statewide)
(800) 222-4446 or
(Helena)
(406) 444-4446

Text
(704) 430-3930

RECOMMENDATION #2 (page 7):

Internal control deficiency

We recommend the Department of Environmental Quality implement internal controls to ensure IT assets are recorded on the state's accounting records in accordance with state accounting policy.

Department response: **Concur**

RECOMMENDATION #3 (page 8):

Internal control deficiency

We recommend the Department of Environmental Quality implement internal controls to ensure the department's pollution remediation obligations are recorded accurately on the state's accounting records.

Department response: **Concur**

RECOMMENDATION #4 (page 9):

Internal control deficiency

We recommend the Department of Environmental Quality implement internal controls to ensure transfer activity related to its Environmental Quality Protection Fund state special revenue account is recorded correctly on the state's accounting records.

Department response: **Concur**

REPORT ON INTERNAL CONTROL AND COMPLIANCE (page B-1):

In this report, we identified the following:

Material Weaknesses in Internal Control: 0

Significant Deficiencies in Internal Control: 2

Material Non-Compliance: 0

Other Matters: 0

For the full context of this information, including the distinction between the types of items reported, see the report beginning on page B-1.

Chapter I – Introduction and Background

Introduction

We performed a financial-compliance audit of the Department of Environmental Quality (department or DEQ) for the two fiscal years ended June 30, 2020. The objectives of the audit were to:

1. Obtain an understanding of internal controls to the extent necessary to support our audit of the financial schedules and, if appropriate, make recommendations for improvements in internal and management controls.
2. Determine whether the financial schedules for each of the two fiscal years ended June 30, 2020, fairly present the results of operations and changes in fund equity, in accordance with state accounting policy.
3. Determine compliance with selected state laws and federal regulations.
4. Determine the implementation status of prior audit recommendations.

We addressed these objectives by focusing primarily on license and permit revenues, federal revenues, personal services and contracted services expenditures, and transfer activity. Additionally, we completed work over cash balances, investments, and reviewed the department's compliance with various state and federal regulations.

As required by §17-8-101(6), MCA, we analyzed the department's internal service fund and determined the fees and charges for services are commensurate with costs and the fund equity balance is reasonable in fiscal years 2019 and 2020.

Background

The department is charged with protecting the environment as guaranteed to the citizens of Montana by the state's constitution. The department's various programs each have their own part in fulfilling this responsibility. The department is organized according to the following programs:

Central Management Division (76.08 FTE) organized under the Director's Office, provides department-wide, central support related to human resources, safety, information technology, financial services, operations project management, and records and information management. The division consists of the Legal Office, the Enforcement Program, Human Resources, Fiscal Services, and the Information Management Bureau. It also provides administrative support to the Board of Environmental Review, which reviews appeals from affected parties regarding administrative decisions made by the department.

Air, Energy & Mining Division (105.52 FTE) permits and regulates operations in accordance with the Montana Environmental Policy Act related to air, hard rock mining, opencut mining, and coal mining industries. The division consists of the Air Quality Bureau, the Energy Bureau, and the Mining Bureau.

Water Quality Division (133.67 FTE) improves water quality through implementing measures that conserve the state's water resources and protects public health. The division consists of the Public

Water Supply Bureau, Water Quality Planning Bureau, Water Protection Bureau, and the Engineering Bureau.

Waste Management & Remediation Division (100 FTE) is responsible for overseeing environmental protection related to underground tanks, solid waste, and remediation of contaminated sites. The division consists of the Federal Superfund and Construction Bureau, the Contaminated Site Cleanup Bureau, and Waste and Underground Tank Management Bureau.

Petroleum Tank Release Compensation Board (5.75 FTE) oversees the Petroleum Tank Release Cleanup Fund, established by §75-11-313, MCA, which reimburses eligible owners and operators for costs of petroleum release cleanup. Fund administration is a joint responsibility of the board and the department.

Libby Asbestos Superfund Oversight Committee was established by Chapter 317, Laws of 2017 (Senate Bill 315). The committee is attached to the department for administrative purposes only. The duties of the committee are to advise the department regarding the administration of the Libby Asbestos Cleanup Trust Fund and the cleanup operation and maintenance account. No FTE was allocated to the committee during the audit period.

Prior Audit Recommendations

The prior audit report for the two fiscal years ended June 30, 2018, contained three recommendations. Prior audit Recommendation #1 related to internal control deficiencies over the recording of financial transactions. We determined this recommendation was not implemented and resulted in Recommendations #1-4 in the current report, starting on page 5.

Prior audit Recommendation #2 discussed the recording of staff time spent on the development of the Tracking Remedial Environmental Actions Data System (TREADS) to its internal service fund. Because TREADS is not a system utilized by the entire department, only the division benefitting from this system should be charged for its development. However, we found the department was recovering the costs of its development from all divisions. We recommended the department only record expenditures in its internal service fund incurred for centrally provided services.

Although the department concurred with the recommendation, it did not implement this recommendation and charged approximately \$21,589 more to its internal service fund for the development of TREADS after the release of our prior audit report in November 2018. However, because the TREADS project ended in December 2018, and we did not identify any non-TREADS related expenditures erroneously charged to the internal service fund during the current audit period, we make no further recommendations at this time, but will continue to monitor internal service fund activity in subsequent audits.

Prior audit Recommendation #3 communicated noncompliance with several state laws, policies, or other regulations related to collective bargaining agreements, excess cash, bad actor law, and student interns. While we determined the department implemented our recommendation to establish internal controls to help ensure future compliance, we found one instance of continued noncompliance. After

the release of our prior audit report, the department sent letters to its student interns informing them they would no longer receive leave and holiday benefits effective in January 2019. However, holiday benefits were paid to two student interns after the January 2019 time period, contrary to state law. Further review revealed this occurred due to the interns being misclassified in the state's accounting system. After working through this issue with department staff, we believe the risk of this specific noncompliance reoccurring is low and we make no further recommendation at this time.

Chapter II – Findings and Recommendations

A control structure is a process designed to provide management with reasonable assurance it will achieve its objectives related to financial accountability and compliance with laws and regulations. State accounting policy charges an agency's management with the responsibility for establishing and maintaining internal controls. Deficiencies in internal control increase the risk the department may not identify inaccurate or fraudulent transactions in a timely manner or be able to ensure the financial schedules are free from material misstatement. During the audit, we identified several instances where the department's controls failed to prevent, or detect and correct in a timely manner, errors in its financial records or noncompliance with applicable policies, laws, and regulations. The following four report recommendations are the result of these identified deficiencies.

Indirect Costs

The department should enhance its internal controls over activity related to indirect costs.

Indirect costs are costs not easily associated with a specific grant, contract, or activity, but are necessary for the general operation of the department. Examples of indirect costs include centrally provided services such as payroll processing, accounting and information technology (IT) support, and procurement assistance. To properly allocate these types of costs in a fair and equitable manner among its various funding sources, the department annually negotiates an indirect cost rate (IDR) with the federal government. This rate is then applied to eligible costs of each division, such as personal services and certain operating costs, and the resulting dollar amount is then recorded as revenue in the internal service fund (ISF). During the audit, we identified two issues related to indirect costs which are further discussed below.

Indirect Cost Rate Calculation Errors

Federal regulations provide guidance for calculating indirect cost rates, including what costs can and cannot be part of the calculation. Rate proposals are then submitted to the federal government for approval. In order to determine if the department complied with federal guidelines, we reviewed the calculation and support for the fiscal year 2019 and 2020 indirect cost rate proposals submitted to, and approved by, the federal government. In our review of the calculations, we found the department incorrectly included direct program costs as indirect costs, included costs that were outside of the base year, manually entered numbers incorrectly, and was unable to provide support for some dollar amounts.

In order to determine the impact of these errors on the financial schedules, if any, we recalculated the indirect cost rate for each of the fiscal years mirroring the department's methodology but adjusting for the errors we identified. While the recalculated rates did not vary significantly from the originals, the differences resulted in DEQ recovering approximately \$153,431 in excess revenue in fiscal year 2019. The rate difference did not impact fiscal year 2020.

Although there is not a material financial impact due to the incorrect IDR computations, the number of errors identified in the department's calculations during the audit period support our determination of an internal control deficiency over the preparation of the IDR.

Per department management, documented procedures to ensure consistency in the calculation process did not exist during the audit period. However, the department does plan to review and document the process to ensure accuracy and consistency in future submissions.

Indirect Cost Recoveries Accounting Errors

As discussed previously, department indirect cost recoveries are recorded in its internal service fund. State accounting policy outlines the proper accounting for indirect cost recoveries. If indirect costs are recovered from a federal fund, the resulting revenue would be recorded in a federal indirect cost recoveries revenue account. When indirect costs are recovered from a non-federal fund, the resulting revenue should be recorded in a charges for services revenue account. However, in fiscal years 2019 and 2020, the department reversed these accounts, recording federal indirect cost recoveries in a charges for services account and vice versa, resulting in misstatements on the Schedule of Total Revenues & Transfers-In for both fiscal years 2019 and 2020, as outlined in Table 1 below.

Table 1
Internal Service Fund Indirect Cost Recovery Misstatements

Fiscal Year	Account Line Item	Amount Over/ (Under)stated
2019	Charges for Services Federal Indirect Cost Recoveries	(\$1,867,354) \$1,867,354
2020	Charges for Services Federal Indirect Cost Recoveries	(\$2,608,718) \$2,608,718

Source: Compiled by the Legislative Audit Division from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS).

Agency management stated the indirect cost recovery errors were a result of an error in the department's calculation tool and personnel have already corrected the tool and updated process documentation to help ensure accuracy going forward.

RECOMMENDATION #1

We recommend the Department of Environmental Quality enhance its internal controls to ensure:

- A. *The indirect cost rate calculation is accurate and supported prior to submitting the proposal to the federal government.*
- B. *Indirect cost recoveries are recorded in the correct accounts on the state's accounting records per state accounting policy.*

Information Technology System Accounting Errors

The department did not have controls in place during the audit period to ensure its information technology assets were recorded on the accounting records in accordance with state accounting policy.

Information technology (IT) systems are an integral part of an agency's day-to-day operations. Information technology systems can help streamline complicated processes, reduce staff workload, and provide better customer service. During the audit period, the department completed the development of two IT systems: the Fees, Applications, Compliance Tracking System (FACTS) and the Tracking Remedial Environmental Actions Data System (TREADS). State accounting policy outlines the proper recording of capital assets on the state's accounting records. However, in fiscal years 2019 and 2020, the department did not accurately record the costs of FACTS and TREADS resulting in misstatements in the accounting records and noncompliance with state accounting policy.

The cost of developing both FACTS and TREADS meets the established threshold to be recorded as capital assets. Capitalizing an asset means that instead of recognizing the full cost of developing the asset in the period the expenditures occurred, the cost is included in the value of the asset and expensed over the useful life of the asset. Per accounting policy, incremental costs associated with system development are recorded as Construction Work-in-Process (CWIP) until the system is complete. Once the system is complete, it is retired from CWIP status and placed in service.

As part of our testing, we reviewed the accounting of several of the department's IT systems on the state's accounting records. We found FACTS and TREADS were still recorded as CWIP, though both were considered substantially complete in June 2018 and December 2018, respectively. In addition, the CWIP amounts had not been increased since June 30, 2017, for either system, though additional costs were paid since that time for the development of the two systems. This resulted in the two systems being understated in the accounting records. See Table 2 below.

Table 2
IT Asset Understatements

IT System	Recorded as CWIP Through 6/30/2017	Total Estimated Cost	Understatement of Assets at 6/30/2020
FACTS	\$776,463	\$967,572	\$191,109
TREADS	\$1,537,692	\$2,638,101	\$1,100,409
Total	\$2,314,155	\$3,605,673	\$1,291,518

Source: Compiled by Legislative Audit Division from SABHRS.

Management stated that in addition to staff turnover, the department lacks internal controls over this process and plans to develop procedures to better track IT system costs in order to be aware of when systems need to be capitalized and when the status of an asset should be updated.

Because the accounting transactions to capitalize these two systems would be completed in the ledger used only for the preparation of the state's basic financial statements, these understatements are not reflected on DEQ's financial schedules. Nevertheless, the underlying accounting records of the department are not accurate which supports our determination of an internal control deficiency over the recording of the department's IT systems.

RECOMMENDATION #2

We recommend the Department of Environmental Quality implement internal controls to ensure information technology assets are recorded on the state's accounting records in accordance with state accounting policy.

Pollution Remediation

The department's controls did not prevent, or detect and correct in a timely manner, significant accounting errors.

One of the primary activities of the department is pollution remediation, which is the removal of pollutants deemed to be having a negative impact on public health and/or the environment. Cleanup efforts of a single contamination can span many years and be very costly to the state. To account for these obligations, state accounting policy requires DEQ to estimate and record its liability related to this activity each fiscal year. However, in fiscal year 2019, instead of recording an estimated long-term liability of \$61,267,000 for the Clark Fork River superfund sites, the department erroneously recorded \$61,267 resulting in its liabilities and pollution remediation expense being understated by \$61,205,733 in its accounting records. Subsequently, the department did not record any pollution remediation liabilities or related expenses in fiscal year 2020. Instead, the entry intended for fiscal year 2020 was recorded in fiscal year 2021. This resulted in an understatement of the department's total liability balance and its pollution remediation expense of \$56,990,461 in fiscal year 2020.

Department management stated there are controls in place over these types of transactions, but staff turnover and inexperience during the fiscal year-end process led to a failure in the internal control and resulted in the above errors.

Because the department's financial schedules are presented on a regulatory basis, these misstatements do not appear on the department's financial schedules. However, the discovery of these misstatements by the State Accounting Bureau resulted in corrections to the State of Montana's 2019 and 2020 basic financial statements, as these liabilities are presented in those reports, and the identified errors would

have significantly misstated the information communicated to the readers. While the State Accounting Bureau's internal controls caught the error in both fiscal years 2019 and 2020, it is still DEQ's responsibility to maintain its own internal control procedures to ensure these transactions are correct prior to the State Accounting Bureau's review.

RECOMMENDATION #3

We recommend the Department of Environmental Quality implement internal controls to ensure the department's pollution remediation obligations are recorded accurately on the state's accounting records.

Prior Year Accounting Errors

The department's controls did not identify transactions recorded to the wrong fiscal year.

The department administers the Environmental Quality Protection Fund (EQPF) state special revenue account. The EQPF is statutorily established as a revolving fund to be used by the department to help fund costs associated with the release of a hazardous substance. Beginning in fiscal year 2019, the department is required by state law to transfer \$1.2 million annually from its Orphan Share state special revenue account to the EQPF. From the EQPF, the department then transfers the money to several other state special revenue accounts according to provisions in state law. However, in fiscal year 2019, the department incorrectly coded these transfers to the prior fiscal year, resulting in overstatements in the prior year line items on each of the fiscal year 2019 financial schedules, as summarized in Table 3.

Table 3
Prior Year Line Item Overstatements

Financial Schedule	Fund/Program	Financial Schedule Line Item	Amount of Overstatement
Schedule of Changes in Fund Equity	State Special Revenue Fund	Prior Year Expenditures & Transfers- Out Adjustments	\$1,200,000
	State Special Revenue Fund	Prior Year Revenue & Transfers-In Adjustments	\$1,080,000
	Permanent Fund	Prior Year Revenue & Transfers-In Adjustments	\$120,000
Schedule of Total Revenues and Transfers-In	State Special Revenue Fund	Prior Year Revenue & Transfers-In Adjustments	\$1,080,000
	Permanent Fund	Prior Year Revenue & Transfers-In Adjustments	\$120,000
Schedule of Expenditures and Transfers-Out	Waste Management & Remediation Division	Prior Year Expenditures & Transfers- Out Adjustments	\$1,200,000

Source: Compiled by Legislative Audit Division from SABHRS.

As with the accounting errors discussed in Recommendation #3 previously, department management stated there are controls in place over these types of transactions, but staff turnover and inexperience during the fiscal year-end process led to a failure in the internal control and resulted in the above errors. However, a well-developed system of internal control would help mitigate these types of situations in future periods.

RECOMMENDATION #4

We recommend the Department of Environmental Quality implement internal controls to ensure transfer activity related to its Environmental Quality Protection Fund state special revenue account is recorded correctly on the state's accounting records.

Summary

As a result of Recommendations #1-4 above, we determined the department has not implemented prior audit Recommendation #1 and significant deficiencies exist in the department's internal controls over the accurate recording of its financial transactions. This is reflected in the report on internal control and compliance on page B-1.

Independent Auditor's Report and Department Financial Schedules

Angus Maciver, Legislative Auditor
Deborah F. Butler, Legal Counsel



Deputy Legislative Auditors:
Cindy Jorgenson
William Soller

INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

Introduction

We have audited the accompanying Schedules of Changes in Fund Equity, Schedules of Total Revenues & Transfers-In, and Schedules of Total Expenditures & Transfers-Out of the Department of Environmental Quality for each of the fiscal years ended June 30, 2020, and 2019, and the related notes to the financial schedules.

Management's Responsibility for the Financial Schedules

Management is responsible for the preparation and fair presentation of these financial schedules in accordance with the regulatory format prescribed by the Legislative Audit Committee, based on the transactions posted to the state's accounting system without adjustment; this responsibility includes recording transactions in accordance with state accounting policy; and designing, implementing, and maintaining internal controls relevant to the preparation and fair presentation of the financial schedules that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions on these financial schedules based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial schedules are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial schedules. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial schedules, whether due to fraud or error. In making those risk assessments, the auditor considers internal controls relevant to the department's preparation and fair presentation of the financial schedules in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the department's internal control, and accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as the overall presentation of the financial schedules.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Basis for Adverse Opinions on U.S. Generally Accepted Accounting Principles

As described in Note 1, the financial schedules are prepared from the transactions posted to the state's primary accounting system without adjustment, in the regulatory format prescribed by the Legislative Audit Committee. This is a basis of accounting other than accounting principles generally accepted in the United States of America. The financial schedules are not intended to, and do not, report assets, deferred outflows of resources, liabilities, deferred inflows of resources, and cash flows.

The effects on the financial schedules of the variances between the regulatory basis of accounting described in Note 1 and accounting principles generally accepted in the United States of America, although not reasonably determinable, are presumed to be material.

Adverse Opinions on U.S. Generally Accepted Accounting Principles

In our opinion, because of the significance of the matter discussed in the “Basis for Adverse Opinions on U.S. Generally Accepted Accounting Principles” paragraph, the financial schedules referred to above do not present fairly, in accordance with accounting principles generally accepted in the United States of America, the financial position of the department as of June 30, 2020, and June 30, 2019, or changes in financial position for the years then ended.

Unmodified Opinions on Regulatory Basis of Accounting

In our opinion, the Schedule of Changes in Fund Equity, Schedules of Total Revenues & Transfers-In, and Schedules of Total Expenditures & Transfers-Out for each of the fiscal years ended June 30, 2020, and 2019, present fairly, in all material respects, the results of operations and changes in fund equity of the Department of Environmental Quality in conformity with the basis of accounting described in Note 1.

Emphasis of Matter

As discussed in Note 1—Basis of Presentation, the financial schedule format was adopted by the Legislative Audit Committee. On June 16, 2020, the Committee approved a change in format to remove the presentation of revenue estimates from the Schedule of Total Revenues & Transfers-In. Our opinion is not modified with respect to this matter.

In fiscal year 2020, the state adopted Governmental Accounting Standards Board Statement No. 84—Fiduciary Activities. Implementation of the standard necessitated the transfer of activity in the department’s Private Purpose Trust Fund to its State Special Revenue Fund. This resulted in the elimination of the Private Purpose Trust Fund on the Schedule of Revenues and Transfers-In. Furthermore, while the Private Purpose Trust Fund is still present on the Schedule of Changes in Fund Equity in fiscal year 2020 due to the transfer of its activity to the State Special Revenue Fund, it no longer shows an ending fund equity balance. Our opinion is not modified with respect to this matter.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated May 17, 2021, on our consideration of the Department of Environmental Quality’s internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the department’s internal control over financial reporting and compliance.

Respectfully submitted,

/s/ Cindy Jorgenson

Cindy Jorgenson, CPA
Deputy Legislative Auditor
Helena, MT

May 17, 2021

DEPARTMENT OF ENVIRONMENTAL QUALITY
SCHEDULE OF CHANGES IN FUND EQUITY
FOR THE FISCAL YEAR ENDED JUNE 30, 2020

	General Fund	State Special Revenue Fund	Federal Special Revenue Fund	Debt Service Fund	Capital Projects Fund	Internal Service Fund	Private Purpose Trust Fund	Permanent Fund
FUND EQUITY: July 1, 2019	\$ (1,053,267)	\$ 201,429,851	\$ 33,395,389	\$ 1,234,596	\$ 6,804,207	\$ (3,740,099)	\$ 27,104,346	\$ 20,701,983
ADDITIONS								
Budgeted Revenues & Transfers-In	8,500	17,651,815	20,450,496			7,530,665		464,778
Nonbudgeted Revenues & Transfers-In	19,802	16,054,999	19,240,452	308,657		5,796		451,493
Prior Year Revenues & Transfers-In Adjustments	39	1,202,515	1,129	(23)		(2,219)		(2,828)
Direct Entries to Fund Equity	5,266,923	16,264,513	(364,829)	1,631,401	(625,715)	320,933	(27,104,346)	
Total Additions	5,295,263	51,173,842	39,327,249	1,940,036	(625,715)	7,855,175	(27,104,346)	913,443
REDUCTIONS								
Budgeted Expenditures & Transfers-Out	5,405,504	33,267,225	19,066,221			7,542,615		
Nonbudgeted Expenditures & Transfers-Out	(8,927)	16,850,577	18,132,152	1,675,310	100,000	178,490		
Prior Year Expenditures & Transfers-Out Adjustments	(21,888)	(461,841)	43,773	296,064		8,316		
Total Reductions	5,374,689	49,655,961	37,242,146	1,971,374	100,000	7,729,421	0	0
FUND EQUITY: June 30, 2020	\$ (1,132,693)	\$ 202,947,732	\$ 35,480,491	\$ 1,203,257	\$ 6,078,493	\$ (3,614,345)	\$ 0	\$ 21,615,426

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-9.

DEPARTMENT OF ENVIRONMENTAL QUALITY
SCHEDULE OF CHANGES IN FUND EQUITY
FOR THE FISCAL YEAR ENDED JUNE 30, 2019

	General Fund	State Special Revenue Fund	Federal Special Revenue Fund	Debt Service Fund	Capital Projects Fund	Internal Service Fund	Private Purpose Trust Fund	Permanent Fund
FUND EQUITY: July 1, 2018	\$ (505,662)	\$ 202,264,438	\$ 31,189,706	\$ 1,518,120	\$ 3,722,489	\$ (4,214,717)	\$ 26,979,569	\$ 19,630,461
ADDITIONS								
Budgeted Revenues & Transfers-In	1,350	17,524,068	20,283,295					
Nonbudgeted Revenues & Transfers-In	56,730	14,231,439	17,496,617	286,408	3,784,071	7,645,030	1,295,997	490,086
Prior Year Revenues & Transfers-In Adjustments	617	831,556	1,728	(27,402)	(253)	8,097	(1,339)	462,837
Direct Entries to Fund Equity	4,576,742	19,276,134	(263,694)	1,367,546	(658,817)	(10,551)		118,599
Total Additions	4,635,439	51,863,198	37,517,946	1,626,552	3,125,000	(2,388)	1,294,657	1,071,522
REDUCTIONS								
Budgeted Expenditures & Transfers-Out	5,187,976	32,002,816	18,821,121		43,282	7,363,280		
Nonbudgeted Expenditures & Transfers-Out		19,680,698	16,528,800	1,710,076		(200,991)	1,169,879	
Prior Year Expenditures & Transfers-Out Adjustments	(4,932)	1,014,270	(37,668)	200,000		3,280		
Total Reductions	5,183,044	52,697,784	35,312,263	1,910,076	43,282	7,165,569	1,169,879	0
FUND EQUITY: June 30, 2019	\$ (1,053,267)	\$ 201,429,851	\$ 33,395,389	\$ 1,234,596	\$ 6,804,207	\$ (3,740,099)	\$ 27,104,346	\$ 20,701,983

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-9.

DEPARTMENT OF ENVIRONMENTAL QUALITY
SCHEDULE OF TOTAL REVENUES & TRANSFERS-IN
FOR THE FISCAL YEAR ENDED JUNE 30, 2020

	General Fund	State Special Revenue Fund	Federal Special Revenue Fund	Debt Service Fund	Internal Service Fund	Permanent Fund	Total
TOTAL REVENUES & TRANSFERS-IN BY CLASS							
Licenses and Permits	\$ 7,500	\$ 11,647,357	\$ 2,413			\$	11,654,857
Taxes	39	2,717,774					2,452
Charges for Services		10,075,569	2,010,842	7,847	2,572,754	341,386	5,290,528
Investment Earnings		797,574					12,435,643
Fines and Forfeits	20,331	1,500,220					817,905
Monetary Settlements		2,138					1,500,220
Sale of Documents, Merchandise and Property		5,750	31,872				2,138
Rentals, Leases and Royalties		1,366,760	96,394	207,295	131	572,058	37,622
Grants, Contracts, and Donations		5,541,654					1,366,891
Transfers-in		529,354					6,417,401
Loan Proceeds					4,955,401		529,354
Federal Indirect Cost Recoveries	471	725,181	30	93,493	5,956		4,955,401
Miscellaneous			37,550,527				825,130
Federal							37,550,527
Total Revenues & Transfers-In	28,340	34,909,329	39,692,077	308,635	7,534,242	913,443	83,386,067
Less: Nonbudgeted Revenues & Transfers-In	19,802	16,054,999	19,240,452	308,657	5,796	451,493	36,081,198
Prior Year Revenues & Transfers-In Adjustments	39	1,202,515	1,129	(23)	(2,219)	(2,828)	1,198,614
Actual Budgeted Revenues & Transfers-In	8,500	17,651,815	20,450,496	0	7,530,665	464,778	46,106,254

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-9.

DEPARTMENT OF ENVIRONMENTAL QUALITY
SCHEDULE OF TOTAL REVENUES & TRANSFERS-IN
FOR THE FISCAL YEAR ENDED JUNE 30, 2019

	General Fund	State Special Revenue Fund	Federal Special Revenue Fund	Debt Service Fund	Capital Projects Fund	Internal Service Fund	Private Purpose Trust Fund	Permanent Fund	Total
TOTAL REVENUES & TRANSFERS-IN BY CLASS									
Licenses and Permits	\$ 5,000	\$ 10,990,556							\$ 10,995,556
Taxes	160		2,058						2,218
Charges for Services	(4,650)	2,452,507	4,983						5,471,500
Investment Earnings	1,200	9,883,261				\$ 3,018,660	\$ 443,777	\$ 466,929	12,808,491
Fines and Forfeits	37,041	589,321	2,009,633	\$ 3,745	\$ (253)				626,362
Monetary Settlements		612,218							612,218
Sale of Documents, Merchandise and Property		16,001							16,001
Rentals, Leases and Royalties		19,250	29,273						48,523
Grants, Contracts, and Donations		1,898,805				28	850,880		2,749,713
Transfers-In	12	5,059,534		207,295	3,784,071			604,594	9,655,505
Capital Asset Sale Proceeds		4,002							4,002
Loan Proceeds		821,478							821,478
Federal Indirect Cost Recoveries						4,615,947			4,615,947
Miscellaneous	19,935	240,130		47,967		7,941			315,972
Federal			35,735,493						35,735,493
Total Revenues & Transfers-In	58,697	32,587,064	37,781,639	259,006	3,783,818	7,642,575	1,294,657	1,071,522	84,478,979
Less: Nonbudgeted Revenues & Transfers-In	56,730	14,231,439	17,496,617	286,408	3,784,071	8,097	1,295,997	462,837	37,622,196
Prior Year Revenues & Transfers-In Adjustments	617	831,556	1,728	(27,402)	(253)	(10,551)	(1,339)	118,599	912,954
Actual Budgeted Revenues & Transfers-In	1,350	17,524,068	20,283,295	0	0	7,645,030	0	490,086	45,943,829

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-9.

DEPARTMENT OF ENVIRONMENTAL QUALITY
SCHEDULE OF TOTAL EXPENDITURES & TRANSFERS-OUT
FOR THE FISCAL YEAR ENDED JUNE 30, 2020

	Air Energy & Mining Division	Central Management Program	Libby Asbestos Super Fund Advisory Team	Petroleum Tank Release Compensation Board	Waste Management & Remediation Division	Water Quality Division	Total
PROGRAM (ORG) EXPENDITURES & TRANSFERS-OUT							
Personal Services							
Salaries	\$ 5,787,905	\$ 4,516,648		\$ 286,936	\$ 5,944,309	\$ 7,526,586	\$ 24,062,383
Other Compensation		294					294
Employee Benefits	2,069,633	1,402,511		124,565	2,182,147	2,773,301	8,552,156
Personal Services-Other		(18,228)					(18,228)
Total	<u>7,857,538</u>	<u>5,901,225</u>		<u>411,500</u>	<u>8,126,455</u>	<u>10,299,887</u>	<u>32,596,605</u>
Operating Expenses							
Other Services	3,391,173	2,458,308	\$ 11,301	45,304	17,240,987	2,613,511	25,760,583
Supplies & Materials	387,282	177,563	166	12,731	212,699	230,479	1,020,920
Communications	132,378	233,777	1,199	5,247	106,872	162,867	642,339
Travel	113,651	36,990	1,929	2,695	83,213	155,015	393,493
Rent	201,022	1,597,295	56		76,917	145,313	2,020,603
Utilities	14,854	4,402			30,307		49,562
Repair & Maintenance	18,479	62,048			12,097	3,400	96,024
Other Expenses	2,187,259	802,575	593	104,285	2,487,180	2,706,227	8,288,119
Goods Purchased For Resale		4,770					4,770
Total	<u>6,446,098</u>	<u>5,377,728</u>	<u>15,244</u>	<u>170,262</u>	<u>20,250,271</u>	<u>6,016,810</u>	<u>38,276,413</u>
Equipment & Intangible Assets							
Equipment	305,139						305,139
Total	<u>305,139</u>						<u>305,139</u>
Capital Outlay							
Buildings		23,000				28,209	51,209
Total		<u>23,000</u>				<u>28,209</u>	<u>51,209</u>
Grants							
From State Sources					1,411,459	204,763	1,616,222
Total					<u>1,411,459</u>	<u>204,763</u>	<u>1,616,222</u>
Benefits & Claims							
From State Sources				4,547,666			4,547,666
Total				<u>4,547,666</u>			<u>4,547,666</u>
Transfers-out							
Fund transfers	1,439,832		468,440	97,427	3,571,160	18,147,310	23,724,168
Total	<u>1,439,832</u>		<u>468,440</u>	<u>97,427</u>	<u>3,571,160</u>	<u>18,147,310</u>	<u>23,724,168</u>
Debt Service							
Bonds	541,263				144,525		685,788
Capital Leases		1,118					1,118
Total	<u>541,263</u>	<u>1,118</u>			<u>144,525</u>		<u>686,905</u>
Post Employment Benefits							
Other Post Employment Benefits		8,938					8,938
Employer Pension Expense		260,327					260,327
Total		<u>269,265</u>					<u>269,265</u>
Total Expenditures & Transfers-Out	<u>\$ 16,589,869</u>	<u>\$ 11,572,335</u>	<u>\$ 483,683</u>	<u>\$ 5,226,855</u>	<u>\$ 33,503,870</u>	<u>\$ 34,696,979</u>	<u>\$ 102,073,592</u>
EXPENDITURES & TRANSFERS-OUT BY FUND							
General Fund	\$ 1,601,503	\$ 877,353			\$ 327,491	\$ 2,568,342	\$ 5,374,689
State Special Revenue Fund	8,194,087	2,355,957	\$ 483,683	\$ 5,226,855	26,614,497	6,780,882	49,655,961
Federal Special Revenue Fund	4,867,430	614,322			6,412,639	25,347,755	37,242,146
Debt Service Fund	1,826,849				144,525		1,971,374
Capital Projects Fund	100,000						100,000
Internal Service Fund		7,724,703			4,718		7,729,421
Total Expenditures & Transfers-Out	16,589,869	11,572,335	483,683	5,226,855	33,503,870	34,696,979	102,073,592
Less: Nonbudgeted Expenditures & Transfers-Out	2,166,379	173,772	452,058		16,011,344	18,124,050	36,927,601
Prior Year Expenditures & Transfers-Out Adjustments	151,829	(17,229)	958	(111,947)	(154,491)	(4,695)	(135,575)
Actual Budgeted Expenditures & Transfers-Out	14,271,662	11,415,793	30,667	5,338,802	17,647,017	16,577,624	65,281,565
Budget Authority	26,651,229	18,762,933	480,000	6,635,063	38,623,680	24,736,066	115,888,971
Unspent Budget Authority	<u>\$ 12,379,567</u>	<u>\$ 7,347,139</u>	<u>\$ 449,333</u>	<u>\$ 1,296,261</u>	<u>\$ 20,976,663</u>	<u>\$ 8,158,443</u>	<u>\$ 50,607,406</u>
UNSPENT BUDGET AUTHORITY BY FUND							
General Fund	\$ 5,238	\$ 15,469			\$ 1,394	\$ 6,342	\$ 28,444
State Special Revenue Fund	4,577,238	5,061,438	\$ 449,333	\$ 1,296,261	8,491,852	1,672,990	21,549,112
Federal Special Revenue Fund	3,012,090	813,745			12,483,417	6,479,111	22,788,363
Capital Projects Fund	4,785,000						4,785,000
Internal Service Fund		1,456,487					1,456,487
Unspent Budget Authority	<u>\$ 12,379,567</u>	<u>\$ 7,347,139</u>	<u>\$ 449,333</u>	<u>\$ 1,296,261</u>	<u>\$ 20,976,663</u>	<u>\$ 8,158,443</u>	<u>\$ 50,607,406</u>

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-9.

DEPARTMENT OF ENVIRONMENTAL QUALITY
SCHEDULE OF TOTAL EXPENDITURES & TRANSFERS-OUT
FOR THE FISCAL YEAR ENDED JUNE 30, 2019

	Air Energy & Mining Division	Central Management Program	Libby Asbestos Super Fund Advisory Team	Petroleum Tank Release Compensation Board	Waste Management & Remediation Division	Water Quality Division	Total
PROGRAM (ORG) EXPENDITURES & TRANSFERS-OUT							
Personal Services							
Salaries	\$ 6,154,250	\$ 4,371,160	\$ 2,645	\$ 269,405	\$ 5,925,161	\$ 7,471,097	\$ 24,193,719
Employee Benefits	2,208,126	1,370,878	1,006	120,874	2,236,902	2,751,119	8,688,904
Personal Services-Other		28,005					28,005
Total	8,362,376	5,770,043	3,651	390,279	8,162,063	10,222,215	32,910,628
Operating Expenses							
Other Services	2,864,491	2,933,264		84,632	17,545,156	2,101,004	25,528,547
Supplies & Materials	227,955	315,673		5,283	279,150	273,669	1,101,731
Communications	118,843	220,951	352	4,605	102,786	150,235	597,772
Travel	174,566	41,009	668	4,018	106,601	170,663	497,526
Rent	210,265	1,605,256			106,402	145,040	2,066,963
Utilities	16,461	4,259			31,662		52,382
Repair & Maintenance	9,980	61,274		325	22,485	20,362	114,427
Other Expenses	2,250,481	772,573	910	98,179	2,451,791	2,725,282	8,299,217
Total	5,873,043	5,954,260	1,931	197,042	20,646,033	5,586,254	38,258,564
Grants							
From State Sources					1,364,339	154,091	1,518,430
Total					1,364,339	154,091	1,518,430
Benefits & Claims							
From State Sources				4,178,274			4,178,274
Total				4,178,274			4,178,274
From Other Sources							
Distrib from Priv Purp Trusts	1,169,879						1,169,879
Total	1,169,879						1,169,879
Transfers-out							
Fund transfers	5,117,225		484,594	32,499	2,684,602	16,492,755	24,811,675
Total	5,117,225		484,594	32,499	2,684,602	16,492,755	24,811,675
Debt Service							
Bonds	541,360				143,825		685,185
Total	541,360				143,825		685,185
Post Employment Benefits							
Other Post Employment Benefits		13,367					13,367
Employer Pension Expense		(64,104)					(64,104)
Total		(50,737)					(50,737)
Total Expenditures & Transfers-Out	\$ 21,063,884	\$ 11,673,566	\$ 490,176	\$ 4,798,094	\$ 33,000,862	\$ 32,455,316	\$ 103,481,899
EXPENDITURES & TRANSFERS-OUT BY FUND							
General Fund	\$ 1,572,207	\$ 808,454			\$ 306,467	\$ 2,495,916	\$ 5,183,044
State Special Revenue Fund	11,694,778	3,075,325	\$ 490,176	\$ 4,798,094	26,243,081	6,396,330	52,697,784
Federal Special Revenue Fund	4,860,769	629,365			6,259,060	23,563,070	35,312,263
Debt Service Fund	1,766,251				143,825		1,910,076
Capital Projects Fund					43,282		43,282
Internal Service Fund		7,160,422			5,147		7,165,569
Private Purpose Trust Fund	1,169,879						1,169,879
Total Expenditures & Transfers-Out	21,063,884	11,673,566	490,176	4,798,094	33,000,862	32,455,316	103,481,899
Less: Nonbudgeted Expenditures & Transfers-Out	6,869,132	(206,138)			15,767,179	16,458,289	38,888,462
Prior Year Expenditures & Transfers-Out Adjustments	60,882	(11,693)		(27,944)	1,212,174	(58,458)	1,174,961
Actual Budgeted Expenditures & Transfers-Out	14,133,870	11,891,397	490,176	4,826,038	16,021,509	16,055,485	63,418,475
Budget Authority	30,020,227	17,896,034	1,199,264	6,595,232	34,206,443	22,794,991	112,712,191
Unspent Budget Authority	\$ 15,886,357	\$ 6,004,637	\$ 709,088	\$ 1,769,194	\$ 18,184,933	\$ 6,739,506	\$ 49,293,716
UNSPENT BUDGET AUTHORITY BY FUND							
General Fund	\$ 6,495	\$ 3,412			\$ 909	\$ 920	\$ 11,735
State Special Revenue Fund	7,547,440	3,768,194	\$ 469,088	\$ 1,769,194	5,263,267	1,057,677	19,874,859
Federal Special Revenue Fund	3,147,422	799,356			12,920,758	5,680,910	22,548,446
Capital Projects Fund	5,185,000						5,185,000
Internal Service Fund		1,433,675					1,433,675
Permanent Fund			240,000				240,000
Unspent Budget Authority	\$ 15,886,357	\$ 6,004,637	\$ 709,088	\$ 1,769,194	\$ 18,184,933	\$ 6,739,506	\$ 49,293,716

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-9.

Department of Environmental Quality

Notes to the Financial Schedules

For the Two Fiscal Years Ended June 30, 2020

1. Summary of Significant Accounting Policies

Basis of Accounting

The department uses the modified accrual basis of accounting, as defined by state accounting policy, for its Governmental fund category (General, State Special Revenue, Federal Special Revenue, Capital Projects, Debt Service, and Permanent). In applying the modified accrual basis, the department records:

- ♦ Revenues when it receives cash or when receipts are realizable, measurable, earned, and available to pay current period liabilities.
- ♦ Expenditures for valid obligations when the department incurs the related liability and it is measurable, with the exception of the cost of employees' annual and sick leave. State accounting policy requires the department to record the cost of employees' annual and sick leave when used or paid.

The department uses accrual basis accounting for its Proprietary (Internal Service) and Fiduciary (Private-Purpose Trust) fund categories. Under the accrual basis, as defined by state accounting policy, the department records revenues in the accounting period when realizable, measurable, and earned, and records expenses in the period incurred when measurable.

Expenditures and expenses may include: entire budgeted service contracts even though the department receives the services in a subsequent fiscal year; goods ordered with a purchase order before fiscal year-end, but not received as of fiscal year-end; and equipment ordered with a purchase order before fiscal year-end.

Basis of Presentation

The financial schedule format was adopted by the Legislative Audit Committee. The financial schedules are prepared from the transactions posted to the state's accounting system without adjustment.

The department uses the following funds:

Governmental Fund Category

- ♦ **General Fund** – to account for all financial resources except those required to be accounted for in another fund.
- ♦ **State Special Revenue Fund** – to account for proceeds of specific revenue sources (other than private-purpose trusts or major capital projects) that are legally restricted to expenditures for specific state program purposes. Department State Special Revenue Funds include permitting and compliance activity for Air Quality Permits, Public Water Supply, Water and Waste Water Operator Certification, Subdivision Review, Montana Pollutant Discharge Elimination System (MPDES), Hard Rock, Coal, Uranium and Opencut Mining, Major Facility Siting, Asbestos Control, Hazardous Waste Management, Junk Vehicle Disposal,

Septic Tank Pumper Certification and disposal site inspections, Solid Waste Management and Underground Storage Tanks. In addition to the permitting and compliance activities, the State Special Revenue Fund includes the Department's Alternate Energy Loan Program and State Building Energy Conservation Program, Orphan Share, Petroleum Tank Release Cleanup, Hard Rock Mining Reclamation, Environmental Quality Protection Fund (State Superfund), and various reclamation bond forfeiture and settlement accounts including Upper Blackfoot Mining Complex, Streamside Tailings, Montana Post and Pole, and Clark Fork remedial action accounts.

- ♦ **Federal Special Revenue Fund** – to account for activities funded from federal revenue sources. Department Federal Special Revenue Funds include federal assistance programs such as the Water Pollution Control and Drinking Water State Revolving Funds, Performance Partnership Grants, Abandoned Mine Lands Reclamation Grant, as well as other federal grants and agreements.
- ♦ **Debt Service Fund** – to account for accumulated resources for the payment of general long-term debt principal and interest. The department uses this fund for recording debt service principal and interest payments for state Hard Rock Mining Reclamation Bonds, Energy Conservation Bonds, and Comprehensive Environmental Response, Compensation and Liability Bonds.
- ♦ **Capital Projects Fund** – to account for financial resources used for the acquisition or construction of major capital facilities, other than those financed by proprietary funds or trust funds. The department uses this fund for accounting for resources recovered from state agencies and component units for repayment of State Buildings Energy Conservation Program projects that are legally committed for construction of future State Building Energy Conservation projects.
- ♦ **Permanent Fund** – to account for financial resources that are permanently restricted to the extent that only earnings, and not principal, may be used for purposes that support the department's programs. The legislature created a trust fund in fiscal year 2005-2006 to cover the long-term costs of water treatment in the area of the Zortman-Landusky mines. The trust was financed from an annual transfer of \$1.2 million from the orphan share fund. The final transfer was done for \$750,000 in fiscal year 2018 when the balance reached \$19.3 million. The department uses this fund for accounting for this trust.

Proprietary Fund Category

- ♦ **Internal Service Fund** – to account for the financing of goods or services provided by one department or agency to other departments or agencies of state government or to other governmental entities on a cost-reimbursement basis. Department Internal Service Funds include indirect charges assessed against all units of the department by the Central Management Program for providing department-wide support functions and services.

Fiduciary Fund Category

- ♦ **Private-Purpose Trust Fund** – to account for activity of any trust arrangement not properly reported in a pension fund or an investment trust fund where the principal and income

benefit individuals, private organizations, or other governments. Department private-purpose trust funds include financial resources held in trust related to permitting activities.

2. Fund Equity Balance

- ♦ **General Fund** - The negative fund equity balance in the General Fund does not indicate overspent appropriation authority. The department has authority to pay obligations from the statewide General Fund within its appropriation limits. The department expends cash or other assets from the statewide fund when it pays General Fund obligations. The department's outstanding liabilities exceed the assets it has placed in the fund, resulting in negative ending General Fund equity balances for each of the fiscal years ended June 30, 2019 and June 30, 2020.
- ♦ **Internal Service Fund** – The negative fund equity balance in the Internal Service Fund does not indicate overspent appropriation authority. The department has authority to pay obligations from this fund within its appropriation limits. Due to generally accepted accounting principles for post-employment benefits and pension liabilities, the department's outstanding liabilities exceed the assets it has placed in the fund, resulting in negative ending Internal Service Fund equity balances for each of the fiscal years ended June 30, 2019 and June 30, 2020.
- ♦ **Private Purpose Trust Fund** – Property held in trust activity has been excluded from the Schedule of Changes in Fund Equity beginning in fiscal year 2020. This change was necessary to facilitate implementation of GASB Statement No. 84-Fiduciary Activities. As a result, there is a decrease in fund equity of \$27,104,346 from June 30, 2019 to June 30, 2020.

3. Direct Entries to Fund Equity

Direct entries to fund equity in the General, State Special Revenue, Federal Special Revenue, Debt Service, and Capital Projects include entries generated by SABHRS to reflect the flow of resources within individual funds shared by separate agencies.

Direct entries to fund equity in the Private Purpose Trust fund during FY 2020 includes entries necessary to implement GASB Statement No. 84-Fiduciary Activities. The entries move property held in trust activities from Private Purpose Trust funds to State Special Revenue funds.

4. Nonbudgeted Revenues & Transfers-In

In the Schedule of Total Revenues and Transfers-In for nonbudgeted revenues and transfers-in, there are several points of clarification, including:

General Fund non-budgeted revenue activity is primarily revenue collected for fines and penalties received for Enforcement activities that are unknown from year-to-year.

Beginning with the fiscal year 2019 and fiscal year 2020 financial schedules opined on in the 2020 cycle, and any compilation engagements requested for 2020 financial schedules, the Schedule of Total Revenues and Transfers-In will no longer report revenue estimate information.

Federal Special Revenue Fund increased \$1.7 million from fiscal year 2019 to 2020. This is attributable to:

- ♦ Drinking Water SRF loan draws decreased by \$2 million.
- ♦ Water Pollution Control draws increasing approximately \$3.5 million.

State Special Revenue Fund increased by approximately \$1.8 million and the Private Purpose Trust Fund decreased approximately \$1.2 million from fiscal year 2019 to 2020. The change is primarily attributed to:

- ♦ Implementation of GASB Statement No. 84 which transferred all property held in trust activities from Private Purpose Trust Funds to State Special Revenue Funds.

Capital Projects Fund transfers were approximately \$3.7 million in fiscal year 2019. There was no transfer activity during fiscal year 2020, resulting in a decrease of activity of \$3.7 million from fiscal year 2019 to 2020. The change is attributed to:

- ♦ The only transfer activity that occurs in the Capital Projects Fund is a result of a biennial sweep occurring each odd numbered fiscal year. This transfer is from the Energy Conservation Repayment Account to the Energy Conservation Capital Projects Account and is in accordance with §90-4-615 and 617, MCA.

5. Nonbudgeted Expenses & Transfers-Out

Waste Management and Remediation division increased \$244,165 from fiscal year 2019 to 2020. The change is primarily attributed to:

- ♦ Nonbudgeted settlement reclamation expenditures including Clark Fork River & Upper Blackfoot Mining Complex and Iron Mountain Custodial.

Water Quality division increased approximately \$1.6 million. The change is primarily attributed to:

- ♦ An increase in the Federal Drinking and Clean Water State Revolving Fund programs. The transfers were made to the Department of Natural Resources and Conservation for disbursement to local governments for construction of water and wastewater system improvements. These grants from EPA are multi-year grants and therefore an analysis of the amount expensed within any twelve-month period is not indicative of any problems or issues with these programs.

The 2019 transfers-out in the Air, Energy & Mining Division include a \$3.7 million transfer for the biennium from the State Special Revenue Fund Energy Conservation Repayment Account to the Energy Conservation Capital Projects Fund Account in accordance with §90-4-615 and 617, MCA.

6. Unspent Budget Authority

The unspent budget authority is primarily in the following areas:

- ♦ State Special Revenue Fund is attributed to the decrease in revenue. Spending is limited to cash balance or authority, whichever is less. If revenue collected decreases spending is also reduced, leaving unspent authority.

- ♦ Federal Special Revenue Fund reflects the unspent multi-year grant authority.
- ♦ Capital Projects Fund for fiscal years 2019 and 2020 is authority earmarked for State Building Loan Program projects.

7. Related Parties

DEQ's Energy Bureau awarded \$25,500 in VW Settlement funds to the City of Helena for three electric charging stations. The award will not be disbursed until the end of fiscal year 2021 or early fiscal year 2022. The City Commissioner for the City of Helena is the spouse of the Business Development Specialist for the Energy Bureau.

There are additional related party relationships with 3 external companies; Pioneer Consulting, CDM, & MT Electric Co-op Assoc (MECA). There were no financial transactions between the department and these 3 companies during fiscal years 2019 and 2020.

The Montana Petroleum Tank Release Compensation Board is an independent board that is attached to DEQ for administrative purposes, ARM 17.58.101. Board members are required to follow Montana's code of ethics, including recusing oneself in matters related to a conflict of interest. In compliance with GASB 62, paragraphs 54-57, the following is to disclose the related relationships identified with Board members:

During fiscal years 2019 and 2020, one board member was also an employee of DEQ. Additionally, board members have relationships with the following companies:

- o Resource Technologies, Inc.
- o Yellowstone Soil Treatment
- o First Interstate Bank
- o Payne West Insurance
- o Rocky Mountain Supply
- o Montana University System
- o Ben Taylor, Inc.
- o Simons Petroleum
- o Sunburst Bulk Plant

The total amount paid to these companies was \$181,414 in fiscal year 2019 and \$373,319 in fiscal year 2020. To ensure we are following state law, all contracts are required to go through a competitive bidding process.

8. Agency Reorganization

Effective 1/1/2020, DEQ transferred the Financial Analyst positions from Financial Services Bureau to the respective program financial units. This change reduces the proprietary fund expense and increases revenue.

Report on Internal Control and Compliance

LEGISLATIVE AUDIT DIVISION

B-1

Angus Maciver, Legislative Auditor
Deborah F. Butler, Legal Counsel



Deputy Legislative Auditors:
Cindy Jorgenson
William Soller

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL SCHEDULES PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

The Legislative Audit Committee
of the Montana State Legislature:

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to the financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the Schedules of Changes in Fund Equity, Schedules of Total Revenues & Transfers-In, and Schedules of Total Expenditures & Transfers-Out of the Department of Environmental Quality for each of the fiscal years, ended June 30, 2020, and 2019, and the related notes to the financial schedules, and have issued our report thereon dated May 17, 2021.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial schedules, we considered the department's internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial schedules, but not for the purpose of expressing an opinion on the effectiveness of the department's internal control. Accordingly, we do not express an opinion on the effectiveness of the department's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial schedules will not be prevented or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that have not been identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify certain deficiencies in internal control, described below, that we consider to be significant deficiencies.

- ♦ The department's internal controls were not effective in ensuring the department's federally approved indirect cost rate is supported and reasonable. See the finding and Recommendation #1A beginning on page 5 for a description of this significant deficiency.

- ♦ The department's internal controls were not effective in ensuring transactions recorded on the primary accounting system were complete, accurate, and in accordance with state accounting policy. See the findings and Recommendations #1B–4 beginning on page 5 for a description of this significant deficiency.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the department's financial schedules are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial schedule amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Department of Environmental Quality's Response to Findings

The department's response to the findings identified in our audit are described on page C-1 of this report. The department's response was not subjected to the auditing procedures applied in the audit of the financial schedules and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the department's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the department's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Respectfully submitted,

/s/ Cindy Jorgenson

Cindy Jorgenson, CPA
Deputy Legislative Auditor
Helena, MT

May 17, 2021

DEPARTMENT OF
ENVIRONMENTAL QUALITY

DEPARTMENT RESPONSE



September 29, 2021

Mr. Angus Maciver
Legislative Auditor
Legislative Audit Division
PO Box 201705
Helena, MT 59620-1705

RECEIVED

SEP 29 2021

LEGISLATIVE AUDIT DIV.

RE: Biennial Financial Compliance Audit #20-16

Dear Mr. Maciver,

Thank you for the opportunity to respond to the biennial financial compliance audit of the Department of Environmental Quality (DEQ). We reviewed the recommendations contained in the report and provided our responses below.

DEQ is committed to improving internal controls and monitoring across the department. The Internal Control Plan (ICP) was scheduled for review and revision due to previous audit findings; however, key staff vacancies and COVID response delayed commencement of the project. During the revision of the ICP, we will concentrate on developing controls and documentation that will improve turnover resilience and reduce weaknesses identified by staff vacancy challenges. Additionally, various projects to improve internal controls are in multiple phases of development across the department which will provide additional foundational support for the corrective action plans below.

Recommendation #1 Response: Concur

We recommend the DEQ enhance its internal controls to ensure:

- a. The indirect rate calculation is accurate and supported prior to submitting the proposal to the federal government.
- b. Indirect cost recoveries are recorded in the correct accounts on the state's accounting records per state accounting policy.

Corrective Action Plan Summary

Part (a) of this recommendation will be addressed through the review and revision of the department's Internal Control Plan (ICP). The department will revise and document the federal indirect rate calculation process and train staff to the new procedure.

Part (b) of this recommendation is resolved. The finding occurred due to a program coding error when automating a manual process. To reduce this type of error in the future, internal controls will be developed to reduce risk of errors created during automation enhancements.

Recommendation #2 Response: Concur

We recommend the DEQ implement internal controls to ensure IT assets are recorded on the state's accounting records in accordance with state accounting policy.

Corrective Action Plan Summary

DEQ capitalized both FACTS and TREADS prior to fiscal year end 2021 and made the appropriate correcting entries for the proper recognition of expenses and prior years' amortization. In addition, documentation has been drafted for an Asset Identification and Capitalization procedure as well as an IT Purchase FAQ to provide additional staff guidance. Review of internal controls for capital asset identification, capitalization, and recording will be prioritized during the ICP revision project.

Recommendation #3 Response: Concur

We recommend the DEQ implement internal controls to ensure the department's pollution remediation obligations are recorded accurately on the state's accounting records.

Corrective Action Plan Summary

Prior to fiscal year end 2021, entries were completed to correct the account balances for pollution remediation obligations for fiscal years 2019 through 2021. In addition, Government Accounting Standards Board Statement #49, Accounting and Financial Reporting for Pollution Remediation Obligations Issued 11/06, will be studied and training provided to staff to ensure that revised procedures for calculating this obligation will be compliant with accounting standards and policy. Revisions to the procedure will be documented and trained through the ICP revision project.

Recommendation #4 Response: Concur

We recommend the DEQ implement internal controls to ensure transfer activity related to its Environmental Quality Protection Fund state special revenue account is recorded correctly on the state's accounting records.

Corrective Action Plan Summary

Although internal control procedures were in place to prevent this type of error, due to staff vacancies, inexperience, and lack of process documentation the control was ineffective. The redesign of this internal control will be prioritized in the ICP revision project.

I want to thank you and your staff for the professionalism and fairness during the audit fieldwork and conferences. We appreciate the willingness of the auditors to discuss recommendations and respond to our questions. We always look upon the audit process as an opportunity to improve the department's operations and performance.

Sincerely,



Christopher Dorrington

Director

Department of Environmental Quality